THE NATIONAL CITY BANK OF NEW YORK

1934

Economic Conditions
Governmental Finance
United States Securities

New York, November, 1934

General Business Conditions

THE reports from business during the past month have shown a favorable trend for the most part, giving evidence of the moderate Fall improvement that had been hoped for. The upturn has been irregular, and there is little in it to encourage the heavy industries, or to create expectations of a vigorous forward movement. Retail trade, however, has continued excellent. Business has had the support of improved retail sales since the middle of August. Department store sales in that month were the best in over two years, allowing for seasonal variations; in September they showed slightly less than the usual increase, but were 4 per cent above a year ago; and in the first half of October, according to reports from 75 cities collected by the National Retail Dry Goods Association, they were 8 per cent above 1933. This showing is decidedly encouraging. The percentages relate to dollar sales, but prices on October 1 were only 1.9 per cent over a year ago, according to the Fairchild index, and the Association states that the number of unit sales was 6.75 per cent larger.

Sales of chain stores and mail order houses in September were 11.5 per cent above 1933, a better gain than was shown in August, and their business has likewise continued good in October. Taken together, these figures signify that the volume of merchandise moved into consumption during the past two months has been larger than a year ago.

On the other hand, industrial production through September had been declining for five months. It has been below the 1933 rate since June, and the Federal Reserve Board's index for September, which was 71 per cent of the 1923-25 average, was the lowest since April, 1933. This decline in the output of goods, in conjunction with increased trade, has reduced inventories, particularly in retailers' hands. All reports indicate that retail stocks and forward commitments are smaller than a year ago.

The situation described should naturally lead to at least a temporary upturn in industrial production, and the preliminary data for October promise such a turn, indicating that the indexes will show the first rise since April. The most pronounced gain in operations is in the textile industry, and is chiefly a rebound from the curtailment caused by the strike. This gives the upward movement a somewhat accidental character. However, the textile industry is precisely the one to benefit in coming weeks from the good retail trade, and thus should lead the way in any further expansion.

Other industries are not entirely laggard. The automobile industry is now in the dull period preceding the changeover to new models, which may come later than was expected. However, it will give more support to business as the year-end approaches. Its orders will help steel and other industries, and steel operations are likely to increase somewhat. A comparison of the activity of the steel-consuming industries with steel production indicates that reserve stocks have been substantially reduced since June, and are still dropping, and miscellaneous orders are holding up well.

Building contracts awarded in the first half of October were 22.1 per cent greater than in September, on a daily average basis, although usually there is little change between the two months. They were also slightly larger than in the first half of October last year, when public works awards were beginning to bulk large. This is the best showing in some months, but the fluctuations are on too low a level to be especially significant.

Effects of Government Disbursements

Business improvement of the character described is based upon the constant need to replace goods of everyday use, which after every dull period causes renewed demands upon the industries making such goods, provided the purchasing power is available. In this case there is an obvious lack of purchasing power due to unemployment in the services and the capital goods industries and to other

161

ravages of the depression, but the lack is partially made up by the Government's relief and emergency expenditures. Exclusive of the R.F.C., whose operations show a credit balance, these expenditures this Fall have been running well above $300,000,000 monthly, whereas last Fall the monthly average was well under $100,000,000. The disbursements included in this category are those of the Federal Emergency Relief Administration, the Civilian Conservation Corps, drouth relief, public highways, river and harbor work, loans to railroads for equipment and construction, loans and grants to States and municipalities for public works. The total corresponds roughly to the Federal deficit.

In addition, rental and benefit payments to farmers, excluding in order to avoid duplication all sums paid for the purchase of farm products by the F.E.R.A., have exceeded $50,000,000 a month this Fall. This is offset by processing taxes and therefore represents a transfer rather than the creation of new purchasing power, but its concentration both in time and place gives it a redoubled effect on trade, as merchants in farm States will testify.

In sum, total disbursements under these headings have recently been placing purchasing power directly into the hands of the public at the rate of over four billions of dollars annually. Total retail sales in 1933, according to the Census, were $25,750,000,000. Thus it may be said that these disbursements during the Fall months are supplying purchasing power at the rate of about one-sixth of last year's retail business. Clearly this is enough to represent the difference between good and poor trade. It supplies the foremost reason for the retail improvement.

It is a significant fact that current business is dependent in such degree upon an arbitrary addition to the purchasing power which arises from the production and exchange of goods within the economic system. It is significant because at some time it will prove impossible to continue making the addition without creating fiscal difficulties, and also because it shows how far short of supporting itself the economic system still falls. We cannot repeat too strongly or too often that the paramount consideration in getting out of the depression is to revive self-supporting industry, for in the modern world there is no other source of support. Only as progress is made toward that end can it be truthfully said that the complex problems raised by the general breakdown are approaching a solution.

Modifications in N.R.A.

The modifications in the policies of the National Recovery Administration that are currently being made or proposed are the most hopeful developments brightening the prospect for economic recovery. This statement implies the opinion that the policies being discarded could at best have only a temporary application, and that if persisted in they would seriously interfere with progress out of the depression; and this opinion has the support of high authority. President Roosevelt in his radio speech on September 30 raised "a serious question as to the wisdom" of devices to fix prices or limit production, and of applying the same codes both to large employers in great industrial centers and to small employers in the smaller communities. Moreover, he doubted "whether in fixing minimum wages on the basis of an hourly or weekly wage we have reached into the heart of the problem, which is to provide such anual earnings for the lowest paid worker as will meet his minimum needs." Manifestly the way to increase annual earnings is to increase the volume of production and thus add to employment, and the general question raised by the President with respect to the policies enumerated is whether they have been "best calculated to promote industrial recovery and a permanent improvement of business and labor conditions."

These are significant statements, for they imply a change of front in the attack on the depression. The evidence indicates that price and production controls will appear in no more codes, and the new policy may lead in due course to their elimination from those already operating. President Roosevelt said of such controls, in the speech above mentioned, that "their effect may have been to prevent that volume of production which would make possible lower prices and increased employment." Mr. Donald Richberg, head of the Industrial Emergency Committee or policy making board of the N.R.A., has made several addresses giving his view that "the ultimate assurance of a fair price . . . must be found in the preservation of a fair price competition and in freedom to produce whatever quantity of goods a free market can absorb."

The New York Times states upon the authority of an unnamed high official that the National Industrial Recovery Board is attacking the problem of recovery "along the line of attracting the consumer by low prices to buy goods." The desired low prices, he adds, are to be achieved by removing the limitations upon the operations of mass-production plants, thus reducing unit costs.

Effects of Controlling Prices and Output

It should be said at once that expectations as to the degree of cost and price reduction that can be accomplished by eliminating price and production controls may easily run too high, and thus are subject to disappointment.

The rise in prices of industrial products has been chiefly due to the increased costs of labor, materials and taxes, rather than to the controls, and to reduce prices the more important elements of cost will have to be dealt with.

Even with this qualification, however, the shift of policy is a landmark in the recovery program. It recognizes that cost reduction and lower prices for manufactured goods provide the way out of the depression, a principle whose acceptance has heretofore seemed in doubt. It concedes in effect that the efforts of an overhead authority to check competition by the exercise of price and production control may go so far as to prevent needed price adjustments, weaken the incentive to reduce costs, protect inefficient and uneconomically located plants, and encourage the holding of goods at prices which prevent them from moving freely into consumption. It gives weight to the undoubted truth that the limitations on machinery installations included in many of the codes may discourage use of new methods and new inventions, although they would give aid to the capital goods industries, and redound to the benefit of everybody. The Times correspondent cites an example as follows:

A textile manufacturer invented a machine or method capable of turning out bath mats in mass production at prices which he thought would assure him first place in that line.

He found that code restrictions on erecting new equipment prevented him from making the necessary changes in his plant, except with the approval of the code authority, composed largely of his competitors.

The restriction on machine-hours, applicable to the textile industry, would prevent him from speeding up production to the point where his output would produce the price results he thought possible.

Much may grow out of the application of the new principles in coming months. In last analysis the depression may be defined as a break-down in the exchange of goods, due to disruption by various forces of the price terms upon which the exchange could be satisfactorily carried on. It follows that recovery will be achieved when prices are established at which goods will again move freely in trade, so that the productive facilities of the country may be used without blockading the markets, and the idle workers may again be given employment.

Within the past month a large shoe company, the Ward Melville Corporation, has had experience with the results of reducing prices of its product. The effects upon employment were set forth as follows in a letter to President Roosevelt, answering charges by a union official that the reductions were against the spirit of the N.R.A. and would result in wage cuts:

Following a reduction in its lower priced product, Melville Shoe recently announced shoes retailing on an average of $7 a pair had been reduced to $5.50. These shoes were being sold to men who would be classed roughly in what is known as the white collar class. Now these men for the most part have not experienced substantial increases in income during the past year. Many of them are salaried men whose dollar income is no more than it was in June, 1933.

After consideration our company decided that it is prepared to gamble on increased unit sales made possible by reduced unit prices. And we are willing to believe that if all companies in this country who are financially able to do so, particularly those engaged in the manufacture and distribution of consumer goods, were to take this gamble, our recovery would be both speedy and assured.

When we lowered our prices and consequently increased our sales at once, we were enabled to transform the factory to which Mr. Goodwin refers from a 1,200-pair per day factory to a 2,400-pair per day factory. Instead of working five half days per week, the operatives are now on a full time basis, and their weekly earnings have increased from 75 to 100 per cent.

This is an illuminating experience. We are not prepared to say to what extent it could be duplicated by other industries. But the farmer is back in the markets with the highest cash income since 1931, and if price reductions through lowered costs could be uniformly effected throughout the industrial system it is a sound assumption that something of the same expansion in trade would take place.

Third Quarter Profits

Corporate reports that have been published during the past month indicate a moderate decline in earnings for the third quarter of the year, reflecting both the lower rate of business activity and the trend toward higher costs. Combined net profits, less deficits, of 190 industrial companies so far reporting, amounted to approximately $93,000,000, compared with $135,000,000 in the preceding quarter and $122,000,000 in the third quarter of 1933. During July, August and September the Annalist's index of business activity averaged about 15 per cent lower than in the same months of last year.

For the first nine months of 1934 the same companies had combined net profits less deficits of approximately $321,000,000 against $182,000,000 in the corresponding period of last year. The nine months' comparisons are influenced, of course, by the exceptionally low totals in the first quarter of last year. Beginning with the second quarter of 1933, the quarterly figures have all run above those of the corresponding periods of the previous year until the September quarter of this year when the trend was reversed.

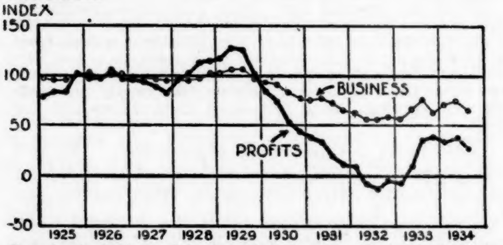
The percentage changes in the actual profits, less deficits, for the third quarter and nine months were as follows:

	1933	1934	% Change
Third Quarter......	$121,978,000	$ 93,010,000	—23.8
Nine Months........	182,096,000	320,635,000	+76.1

The numbers of individual companies that showed increases and declines in profits for 1934 as compared with 1933 were as follows (expressed in percentages of the total number):

	Increases	Decreases
Third Quarter	39.5%	60.5%
Nine Months	74.2	25.8

The general trend of quarterly profits over a period of years is shown by the index below, which is based on average rate of return on net worth of 200 of the more important industrial corporations, with the latest quarter partly estimated, and is adjusted for seasonal variation.



Quarterly Index of Industrial Corporation Profits and the Annalist Index of Business Activity. 1926=100.

Since the decline in earnings from the second to the third quarter this year was more than seasonal, the adjusted index is slightly lower.

Changes Among the Major Industries

A summary of the tabulation by major industrial groups is given in the accompanying table. Profits for the nine months' period represented, upon their net worth aggregating $8,404,000,000 after substantial write-downs during recent years, an annual rate of return of 5.1 per cent in 1934 compared with 2.8 per cent in 1933. As has been pointed out in the past, these figures indicate simply the trend of earnings and naturally do not provide an accurate measure of the rate of earnings for industry as a whole. Percentage rate of return on the limited group of leading corporations that publish quarterly statements has, over a period of years, averaged about 5 per cent higher than the rate of return for all manufacturing corporations in the United States, as shown by the "Statistics of Income" when published.

It will be observed from the table that for the nine months' period most of the industrial groups registered an improvement. A feature of the reports is the continued low level of earnings in the industries making capital goods, even after the revaluation of assets and capital, which has lowered fixed charges and made it possible for many companies to break even on a much reduced volume of business. Some improvement, however, has been made in the heavy industries this year, even though in numerous instances the improvement is merely in cutting down the size of the deficit. Results for the nine months were better than those of last year for numerous companies engaged in the production of building materials, machinery, electrical equipment, office equipment, non-ferrous metals, chemicals and miscellaneous products, while the iron and steel group had a smaller deficit than a year ago. These indicated changes, of course, are not conclusive as to results for the entire industries, because of the small number of companies represented.

Railroad net income for several months has been running below that of the preceding year due to the higher labor and material costs, rate-cutting and the failure of traffic to expand appreciably. Class I steam railroads reporting

INDUSTRIAL CORPORATION PROFITS FOR FIRST NINE MONTHS

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits Nine Months 1933	Net Profits Nine Months 1934	Per Cent Change	Net Worth January 1 1933	Net Worth January 1 1934	Per Cent Change	Annual Rate of Return 1933	Annual Rate of Return 1934
1	Autos—General Motors	$ 81,410	$ 92,445	+ 13.5	$ 860,869	$ 871,498	+ 1.2	12.6%	14.1%
6	Autos—Other	D- 4,415	D- 6,634	....	110,590	101,966	— 7.8	......	......
17	Auto Accessories	2,725	9,488	+248.2	130,486	122,784	— 5.9	2.8	10.3
4	Baking	14,719	12,149	— 17.4	212,148	204,451	— 3.6	9.2	7.9
8	Building Materials	D- 2,947	3,250	+	187,747	174,780	— 6.9	......	2.5
13	Chemicals	49,114	70,793	+ 44.1	913,362	920,250	+ 0.8	7.2	10.3
5	Electrical Equipment	5,082	15,413	+203.2	480,317	472,842	— 1.6	1.4	4.3
12	Food Products—Misc.	41,559	42,448	+ 2.1	480,771	473,806	— 1.4	11.5	11.9
1	Iron and Steel—U. S. Steel	D-28,075	D-11,466	....	1,911,145	1,869,187	— 2.2	......	......
11	Iron and Steel—Others	D-15,190	D- 3,306	....	861,946	837,190	— 2.9	......	......
12	Machinery	D- 1,564	4,311	+	99,833	92,674	— 7.2	......	6.2
6	Merchandising	D- 818	957	+	94,806	96,105	+ 1.4	......	1.3
6	Mining, Non-ferrous	2,225*	6,717*	+201.9	105,875	107,611	+ 1.6	2.8	8.3
4	Office Equipment	3,588	9,235	+157.4	127,889	116,626	— 8.8	3.7	10.5
5	Paper Products	1,133	1,354	+ 19.5	66,105	61,243	— 7.4	2.3	2.9
15	Petroleum	D- 6,835	17,082	+	955,330	948,486	— 0.7	......	2.4
7	Textile Products	2,598	1,631	— 37.2	58,074	62,301	+ 7.3	6.0	3.5
42	Miscel. Manufacturing	32,018	49,974	+ 56.1	642,924	637,810	— 0.8	6.6	10.4
15	Miscel. Services	5,769	4,794	— 16.9	254,231	231,986	— 8.7	3.0	2.8
190	Total	$182,096	$320,635	+ 76.1	$8,554,448	$8,403,596	— 1.8	2.8	5.1

D—Deficit. *Before certain charges.

to the I.C.C. had a combined net deficit after operating expenses and interest charges, but before dividends, of $32,000,000 in the first seven months of this year, and preliminary figures for later months indicate no real improvement. In the full year 1933 there was a deficit of $14,000,000 and in 1932 a deficit of $151,000,000, the year 1931 being the last in which a profit was shown.

Net income of a group of 35 important electric light and power systems totaled $132,043,000 for the twelve months ended September 30, 1934, as compared with $155,731,000 in the corresponding period a year ago, representing a decline of 15.2 per cent. American Telephone and Telegraph Company had net income of $90,203,878 for the first nine months, as compared with $101,351,844 in the same period last year.

Money and Banking

While member bank reserves are no longer increasing, owing largely to a slackening in the rate of gold imports in recent months and a seasonal increase in the demand for currency, the volume of excess reserves has continued very large, the totals on October 24 being $534,000,000 for New York City banks and around $1,770,000,000 for all member banks. Interest rates, in consequence, have yielded in some instances to further low levels, bankers' acceptances dropping $\frac{1}{16}$ on all maturities up to 90 days to new low levels of $\frac{3}{16}$ per cent bid and ⅛ per cent asked, while average discount rates on new offerings of 180-day Treasury bills eased from 0.29 per cent a month ago to 0.19 per cent on October 31. On the 26th, mutual savings banks in New York City announced that dividends to depositors for the last quarter of this year would be at an annual rate of 2½ per cent, against 3 per cent for the third quarter.

Total loans and investments of reporting member banks increased about $60,000,000 in the four weeks ended October 24, due principally to the further rise of "all other" loans, whose steady increase since July has pointed fairly definitely to expanding business borrowing, doubtless in part seasonal. Net demand deposits continued to increase, reaching a new high level since July 1931. Of the increase of $2,700,000,000 in this item over the past year, the greater part has reflected the disbursement by the Government of funds obtained through sales of securities to the banks.

Bond Market Firmer

Bond prices continued in October the improvement begun in the latter part of September. Highest grade corporation bonds recovered to near the peak levels of last July, while Government bonds reached a point about midway between the July highs and the early September lows. Completion of the October 15 refinancing, with exchanges into new notes and bonds of $1,020,000,000 of Fourth 4¼'s, out of $1,250,000,000 called for payment, the announcement by the Treasury that it was calling an additional $1,870,000,000 of Fourth Libertys for payment April 15, 1935, and the President's denial on October 12 that further devaluation of the dollar was contemplated at this time, were among the factors mentioned in connection with the better tone in the market, though probably a recovery was due simply on the basis that the decline had been overdone.

Foreign Exchange Rates

A feature of the foreign exchange market has been the strength of the pound sterling and weakness of European gold currencies following the assassination of King Alexander on October 9. London funds rose above $5.00 and 75.60 francs, and francs eased in terms of dollars to around the gold point for shipment to New York. Evidently a new wave of uneasiness regarding Continental conditions has given rise to an outflow of funds that has reversed, for the time being at least, the trend of the fore part of the month when sterling dropped to a new low of 73.50 francs and $4.89⅛, the latter rate equivalent to $2.89 in terms of old dollars. These sudden shifts of short-term balances are evidence of the unsettled state of opinion everywhere which is proving so great a handicap to recovery.

Within the past month representatives of seven European nations constituting the Gold Bloc, in conference in Brussels, have reaffirmed their determination to maintain the existing gold values of their currencies, and have pledged themselves to efforts to expand mutual trade as a means of combatting pressure for devaluation.

With imposition by the Chinese Government of the export tax on silver, Chinese exchange dropped from 36⅞ cents to 32⅝, representing a discount of about 10 per cent as compared with silver. A decline of Japanese yen to a new low of 28.48 cents in terms of devalued dollars was attributed to weakness in Chinese exchange, continued budgetary difficulties, expectation of large transfers in connection with purchase of the Chinese Eastern Railway, and typhoon damage in September.

All of which lends force to the plea made by the United States Ambassador to Great Britain, in a recent address in Edinburgh, for stabilization of the dollar and the pound sterling in relation to each other as a first step in the direction of world stabilization.

Chinese Embargo on Silver Exports

The action of the Chinese Government within the past month in imposing a tax and equalization fee on exports of silver has been

a new development in the silver situation resulting from the program of United States Government silver purchases. In taking this step the Chinese authorities have been prompted by two motives, (1) to check the heavy loss of silver which has been threatening to strip the country of its circulating medium, and (2) to prevent higher silver prices from being translated into equivalent advances in Chinese exchange, with a resultant deflationary effect upon Chinese internal prices.

That China would be forced eventually to some action of this kind was believed probable by most persons familiar with the monetary system of that country. Evidence that these expectations were well founded was not long in presenting itself once this Government set out in earnest to carry out the terms of the Silver Purchase Act of last Summer. It will be recalled that this Act declared it to be the policy of the United States to maintain 25 per cent of its monetary reserves in silver, and directed the Secretary of the Treasury to purchase silver sufficient to that end, subject to executive discretion as to time, rapidity of accumulation, and prices. To carry out these terms it was calculated that the purchase of silver would run as high as 1,300,000,000 ounces, of which probably a billion ounces would have to be bought abroad.

Chinese Balance of Payments Already Unfavorable

It should be said at the outset that there has been for some time a tendency for silver to flow out of China by reason of an unfavorable balance of payments. In other words, the recent silver moves on the part of the United States probably have not been the only reason for the exodus of Chinese silver, though they undoubtedly have greatly stimulated it. An indication of the trend of the balance of payments may be had by reference to the movements of gold and silver in and out of China, since it is with these metals that the differences in international payments are settled. The following table from the bulletin of Nankai Institute of Economics gives the movements of the precious metals in and out of China over the past six years:

Movements of Gold and Silver To and From China
(In Million Yuan Dollars)

	Net Exports (—) or Imports (+) of gold	Net Exports (—) or Imports (+) of silver	Net Exports (—) or Imports (+) of both
1928	+ 9.3	+164.1	+173.4
1929	— 3.1	+163.9	+160.8
1930	— 25.5	+103.2	+ 77.7
1931	— 49.3	+ 69.8	+ 20.5
1932	—110.7	— 11.6	—122.3
1933	— 66.9	— 14.2	— 81.1

In 1928 and 1929 China had large favorable balances of payments, as shown by the large imports of silver during those years. In 1930 it is evident that a change was taking place. Net imports of silver fell off sharply, and net exports of gold increased. By 1931 the favorable balance of payments had so shrunk as to permit of net silver imports only barely in excess of net gold exports, and by 1932 the balance was definitely adverse, China showing net losses in both gold and silver, with similar tendencies recorded in 1933.

Effect of U. S. Purchases

With the balance of payments already running against China, the currency difficulties of that country were brought quickly to an acute stage by the appearance of the United States Treasury in the market as a large buyer of silver. A rush of speculative demand carried prices up from 45 to around 50 cents, and started a heavy flow of silver from China to the United States. As this movement continued and grew more threatening to the monetary stability of China, the talk of an embargo added to the general feeling of alarm and contributed to haste on the part of holders of Chinese currency to convert such holdings into foreign currency. Thus, exports of silver from China since June 30 have been 167,000,000 yuan dollars (equivalent to approximately $56,000,000 U. S.), against 198,000,000 yuan dollars since the first of the year, with every prospect that the movement would continue unless restrictive measures were taken.

Importance of Silver to China

Inasmuch as silver is the basis of the Chinese monetary system, it was clear that the Chinese Government could not permit such a movement to continue very long. Loss of silver from China has the same effect upon the Chinese economy that loss of gold has upon countries on a gold basis, forcing a contraction in the volume of credit and means of payment, with disastrous effects upon business and prices.

As a matter of fact, China probably is considerably less prepared to stand a heavy loss from its metallic stocks than most of the gold countries. In the latter, very little gold is in actual circulation, but is largely concentrated in the central banks. In such cases a loss of gold is reflected first in a reduction in central bank reserves. Usually, however, this is offset in part by an expansion of central bank credit, so that unless the gold movement is very heavy the total volume of currency and bank deposits, which constitute the media of payments, may be affected relatively little. In China, on the other hand, where a great deal of the silver is in actual circulation, a loss of

silver translates itself more promptly into a shrinkage of the circulating medium, and hence quickly becomes a serious matter.

China Protests U. S. Silver Policy

Moved by the gravity of the situation, the Chinese Government tried early in September to control exports of silver by limiting dealings in foreign exchange to strictly commercial and reasonable personal requirements. Finding these measures ineffectual, the Government then addressed a protest to the United States, calling attention to the serious consequences to China of our silver policy, and intimating that if the policy continued China might be forced to abandon silver for a gold currency. In addition, the suggestion was made that, since the United States wanted more silver in its monetary reserves, the Chinese Government would be willing to consider a proposition to exchange silver directly with our Government for gold. This note read in part as follows:

> Since 1931 the rising of silver value in terms of foreign currency has involved severe deflation and economic losses to China and has dislocated China's balance of payments, in part at least, by hampering exports. Recently the stimulation of silver prices abroad, to which exchange has not fully responded, has caused serious drain of silver, creating great alarm.
>
> Silver exports of this year to date are over three times greater than any previous full year. Further material silver price increase would cause very serious injury to China, possibly severe panics. Although influential American circles advocate higher silver prices, the Chinese Government, of course, makes no assumption concerning the American policy in this regard.
>
> China is certain that the American Government desires to avoid any action that may aggravate present conditions, and therefore would appreciate an assurance that the American Government would refrain from any action that might cause a continuation of the present silver drain from China, and, accordingly, would cooperate to prevent further rise and to maintain the stability of silver which the London agreement contemplates. Indeed, from China's viewpoint, the stabilized level should be somewhat lower than the present price.
>
> The National Government feels obliged actively to seek means of avoiding further hardships of silver fluctuation. It considers that China should not alone maintain the silver standard and is considering the gradual introduction of a gold basis currency, which will necessitate the acquiring of gold.
>
> Since the American Government desires an increased proportion of silver in its monetary reserve, the National Government desires also to ascertain in principle whether the American Government is willing to exchange with the Chinese Government gold for silver.

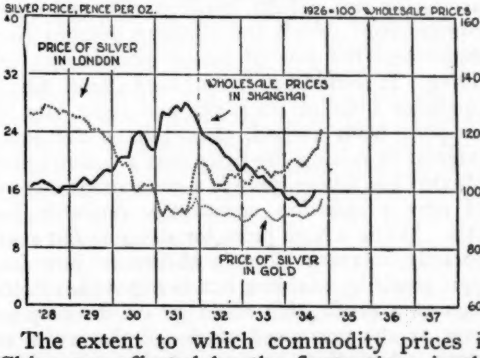
In a subsequent note, dated October 2, Dr. H. H. Kung, the Chinese Finance Minister, again emphasized the critical nature of the Chinese situation.

Replying to these communications, the American Secretary of State, Mr. Cordell Hull, expressed the desire of this Government to avoid so far as possible disturbances to the Chinese economy, but intimated that the purchases would have to go on, pointing out that the program had been made mandatory upon the Executive by Act of Congress. As for the proposal to exchange silver for gold between the two Governments, the note stated that "free markets in which gold and silver could be acquired by purchases are now open to all nations, and, therefore, direct inter-governmental transactions have not been undertaken."

Failing to receive satisfaction from this exchange of notes, the Chinese Government then determined upon the defensive measures to which we have already referred. The charge of 2¼ per cent already levied on exports of bar or sycee silver was raised to 10 per cent, and made inclusive of silver coin as well, in addition to which an equalization fee was provided for to offset any differential between the price of silver in London and the rate of exchange as fixed by the Central Bank of China. By this means it was hoped both to check the outflow of silver and to prevent a rise of exchange that would be detrimental to the internal price structure.

Silver Prices and Chinese Purchasing Power

Much has been said by the advocates of doing something for silver of the supposed benefits of such a program in increasing the purchasing power of China. The truth is that China is no more interested in having its currency appreciate in value than are other countries in seeing a similar movement in their own currencies. In China, as elsewhere, a rising currency means increasing difficulty in selling goods abroad and deflation of all internal costs and prices. With most of the nations trying to depreciate their currencies in order to help their export trade and bolster up their internal price levels, there seems a strange inconsistency in urging an opposite policy as advantageous to the Chinese. That the latter are not impressed by the outside efforts to increase their purchasing power by these means is evidenced clearly by the official correspondence from which we have just quoted.



The extent to which commodity prices in China are affected by the fluctuations in the foreign value of silver is revealed by the accompanying diagram comparing the course of

an index of wholesale prices in Shanghai with the price of silver in terms of pounds sterling and in gold.

It will be seen that the picture presented is one of an almost perfect inverse correlation. While silver prices were falling in 1929 and 1930 China was enjoying a commodity price boom. This boom reached its peak at about the same time that silver prices reached their lowest point in 1931. From then on, as silver has appreciated, commodity prices in China have been undergoing continuous deflation. Although the rise of silver shown in the diagram has been largely a reflection of the depreciation of the pound sterling, the effect, nevertheless, on the Chinese economy is the same whether the rise is a genuine improvement in terms of gold or merely a rise in terms of depreciated money. In either case there is a rise in the value of Chinese money relative to other currencies, which puts Chinese exporters at a disadvantage and imposes pressure on internal prices.

The fact that the commodity price index has been moving upward for several months in spite of the further sharp rise of silver would seem to be, at first sight, a contradiction of this principle. Probably the explanation lies in the inclusion in the index of certain staple commodities such as wheat and rice, which, owing to short crops, have advanced enough both in China and in world markets to offset the rise of silver. Had it not been for this rise of prices due to diminished supplies there is reason to believe that the crisis in China caused by recent movements of silver would have been much more severe.

It is true that to the extent that silver is used in China as a store of wealth a rise in the value of these stocks will enhance the purchasing power of the holders. Such an increase in the value of silver hoards will be dearly paid for, however, if purchased at the cost of low prices for rice, wheat, tobacco, silk and other commodities which the Chinese peasant produces and the sale of which affords him his living. It should be obvious that China, which produces little or no silver and must buy its supplies from abroad, cannot have the same interest in raising the price that a country like Mexico has where there is a continuous stream of new production constantly available for sale. While a high price for silver might temporarily increase China's ability to buy foreign goods by enabling her to export her holdings at a profit, this could go on for only so long as she possessed stocks of the metal to spare. And this, because of the part which silver plays in the monetary system, would not be for long.

In this connection we are prompted to quote the views of an eminent Chinese banker, Mr. Li Ming, Chairman of the Bank of China and of the Chekiang Industrial Bank, who, on the occasion of his visit to New York in September, said in part:

> The theory that by raising the price of silver, China would be able to buy more in America or America would be able to sell more to China is not economically sound. The effect, if any, would be very short-lived, as China could not afford to pay for American imports of commodities with exports of silver because she needs all the silver she has for her medium of exchange.
>
> America's purchasing power is not measured by the gold you possess, but is measured by the productivity of your national wealth. China, like every other country, pays for her imports chiefly by her exports. The silver in her possession, no matter how big that amount may be, does not help much in her purchase abroad. She will have to depend upon her exports and her exports alone.

The Problem of Future Supplies

Action by the Chinese Government in imposing restrictions upon the outflow of silver has shifted attention from China to India as a principal source of supplies from which the United States might draw, since outside of China and India there are no large stocks available. At the present time, stocks of silver in the Indian Treasury amount to around 338,000,000 ounces, having been reduced by 118,000,000 ounces since the peak in 1931. Doubtless these holdings could be reduced still further, though how far the Indian Treasury would want to go in denuding itself of a metal still in great demand throughout India is a question. In addition to the stocks in the Indian Treasury there are vast hoards of silver in the hands of individuals, some of whom might be induced, by a price high enough, to exchange their silver for our gold. On the other hand, it must be remembered that rising prices often have the effect of making holders reluctant to sell, and, as a matter of fact, recent reports from India have been to the effect that, with silver sentiment bullish, Indian operators have been consistent buyers in the London market.

Of course, the higher price for silver and any further advances that may occur will tend to stimulate mining production, but increased supplies from this source are likely to come forward slowly.

The announcement of the Chinese embargo was followed by a sharp rise of silver prices to a new high of 55¼ cents, from which there was subsequently a reaction to 53⅛ cents. Should China and India withhold sales in the face of continued bidding by the United States Government, it is possible that the price could be run up rapidly towards the statutory limit of $1.29 an ounce without the Treasury actually acquiring any very large quantity of silver. However, as the price approached this limit, holders of silver for the rise presumably would

take profits, thus dumping large quantities of silver on the United States Treasury at top prices. With all speculation for a further rise eliminated, there is no reason to suppose that silver could be held at these levels without co-operative action by other governments in buying silver at these prices.

Will the Chinese Embargo Be Effective?

Whether the measures which China has adopted to protect her currency will prove to be effective or not remains to be seen. Probably a great deal will depend upon the policies pursued by the United States. If this country continues to push up the price of silver China will be forced to a higher and higher tax in order to defend her monetary system. For the United States to enter into any such competition would be clearly antagonistic to the interests of China, whereas the program heretofore has been represented by the silver advocates as designed to aid China. The basis of the London Agreement on silver was that all nations should cooperate in the measures taken to rehabilitate that metal.

Moreover, the higher the price of silver outside of China, and the wider the premium over the internal value on account of the tax, the greater will be the incentive to smuggling. That this might develop to the point of becoming a real menace to the monetary system of the country is indicated by the experience with the gold embargo which has been in effect since May 1930. This embargo, imposed on all exports save those through the Central Bank, caused gold to sell at a discount internally, as is now the case with silver. The result was to greatly stimulate smuggling. Just how much gold was involved in these activities cannot be said definitely, but Sir Arthur Salter states in the report which he recently presented to the Chinese Government in his capacity of Economic Adviser that "it is probably safe to say that at least as much gold has been smuggled out as has been officially recorded. That is to say, instead of an export in the two years 1931 and 1932 of $176,000,000, the real export was probably well over $300,000,000."

Possibilities If Embargo Fails

Should China prove unable to protect her currency reserves it is difficult to foretell precisely what would happen. The Chinese Government has indicated that it might be compelled to adopt the gold standard; obviously, however, there are serious difficulties in the way of so fundamental a change. The suggestion has been made that China might follow the example of certain western nations, and revalue her currency; but here, too, there are important objections, including the fact that only a small proportion of the metallic stock is held by the Government, most of it being in the hands of the banks and individuals.

A more likely effect of a continued drain of silver from China would be to force the country on to a paper basis, which would be the worst of all possible outcomes, since such a currency would almost certainly depreciate in value. For the past several years efforts have been made by the banks to accustom the people to a wider use of bank notes instead of hard cash, with the result that the circulation of the nine Chinese note-issuing banks in Shanghai, including the Central Bank of China, was reported at 325,000,000 yuan dollars at the end of April, 1934, against 264,000,000 yuan dollars a year previous, and 194,000,000 yuan dollars two years previous. As an example of the efforts already being made to foster a wider acceptance of paper money, the Central Bank is paying all Government accounts, salaries and soldiers' wages at numerous points in the interior in Central Bank notes so that the public is becoming accustomed to this form of currency.

Any development tending to create a shortage of silver would naturally induce the Government to further efforts of this kind to encourage the use of notes as a means of economizing specie. Obviously, from the standpoint of the silver interests, this would be a far from satisfactory outcome of their efforts to promote a wider use of silver as money. From the standpoint of China, it would not be objectionable, providing the convertibility of the notes is maintained. The danger is that convertibility would not be maintained. If the drain of silver from China should continue it could not be maintained. And China on an inconvertible paper basis would be both a menace to herself and a highly disturbing factor in Far Eastern trade.

Situation Producing New Uncertainty and Confusion

It ought to be clear that the way back to monetary stability will not be made easier by dragging China off the silver standard. (Nor, for that matter, will that be a good way to increase the monetary use of silver.) Already the effect of the export tax and equalization fee has been to divorce Chinese exchange from silver and give the Chinese a weapon for depressing their own currency. Thus, those who have advocated raising the price of silver as a means of making Chinese goods dearer in world markets may find that their efforts, instead of lessening Far Eastern competition, have actually increased it.

Should a weakening of the Chinese dollar precipitate a new currency war in the Far East the difficulties of avoiding further disorder in

western currencies would be increased. With the fall in Chinese exchange, Japanese yen have shown renewed softness. Fluctuations in both of these currencies have a bearing on the course of the pound sterling, and give encouragement to revaluationist sentiment in the Gold Bloc, particularly in the Netherlands, whose eastern colonies in the Dutch East Indies are especially exposed to Chinese and Japanese competition. In short, the situation in China has introduced new complications in the general state of world confusion, with ultimate consequences that cannot yet be foreseen.

The Division of Wealth and Income

We have given considerable space in recent numbers of this publication to discussion of general income-distribution and the profits of business. One reason for doing so is that more authentic information on the subject has become recently available than has been available heretofore, and another reason exists in the veritable flood of falsehood and misrepresentation upon the subject which is being spread throughout the country.

It cannot be doubted that the state of confusion and strife which exists in industry, and which is retarding the recovery of business and employment, results in great degree from these misrepresentations. Many persons appear to have accepted the idea that the economic system is inherently unjust in its distribution of the industrial product, and it is not strange that this belief should exist, in view of statements repeated over and over by persons of high position, intelligence and education, purporting to give information as to the distribution of income in the United States. It may well be believed that usually these statements are merely passed along ignorantly, and in this sense innocently, having been unconsciously absorbed and become the basis of uninformed conviction.

This agitation has been greatly stimulated by the disorder existing in industry throughout the last five years, which has been assumed to be an example of the normal workings of the free economic system and to afford proof that the system is fundamentally defective and that some system of overhead control must be substituted for it.

It is twenty years since the war broke out, and inasmuch as few persons know much of business life until after they are twenty years old, it follows that the section of our population which is not above forty has known little of normal economic conditions. Such persons may well be impressed that the conditions of the last five years have been very bad, and thus be receptive to the theory that the economic system should be radically made over.

Unfortunately there is no general appreciation of the fact that the world is paying the penalty of an adventure in violation of economic law on the most colossal scale known in the history of mankind. We have described the effects of the war upon the economic system so often heretofore that we shall not dwell upon them here. It suffices to say that throughout all of the twenty years from 1914 to 1934 there has been little opportunity for the economic system to function under the natural play of economic forces.

The irregularities, the fluctuations, the inequalities and injustices attributed to the free economic system have not resulted from the normal workings of the system, but from interference with them, from disregard of economic law and attempts to evade or suppress it.

The Actual Distribution of Income

The root grievance against the economic system is the alleged injustice in the distribution of the values arising from it, but what that distribution is has now ceased to be a matter of surmise and need no longer be in serious controversy. Everybody should welcome the facts and be content to let them be the basis of argument regarding public policies.

In our April number we reviewed at length the study of the distribution of the National Income in each of the four years 1929-1932, made by the National Bureau of Economic Research, Inc., for the Department of Commerce, and embodied by the latter in its report to the United States Senate in response to a Senate resolution. This Report gives the results of the most thorough study of the distribution of income in this country that ever has been prepared. In the May number we reviewed a study by the same research organization of the profits of all corporations in the United States over the six years 1927-1932, and in the August number we returned to the study of individual incomes for the purpose of exposing more specifically the pestilent falsehood that three or four per cent of the population receives 80 or 90 per cent of the total national income.

The information thus officially supplied should not be permitted to drop out of sight and be forgotten, as happens with much valuable information gathered by experts into public reports. If it is neglected and remains unknown except to the few who read public documents, this flood of misrepresentation about a matter of vital concern will sweep on, gathering force until the economic system under which all of the progress of the past has been made is utterly wrecked and organized society sinks into anarchy. To emphasize and enforce the most important points of the reviews that have been given we summarize some of them below.

Although income is computed in terms of money, all real income is in goods or services,

and as produced comes first into the hands of proprietors, to wit: corporations, partnerships, or individual producers. The authors of this official report found it desirable to distinguish between "income produced" and "income paid out," the former consisting of the total value of all goods and services produced during each year and the latter of income actually paid out or drawn out and distributed from first hands into circulation during the year. Thus in the case of corporations the distribution is by way of salaries, wages, interest and dividends, but a portion of values produced may be retained in their business, or, as in the three years ended with 1932, capital may be drawn upon for distribution in the channels named. The figures in the small table following are for the division of "income paid out" as between labor and property in the two years named, as shown by Table 3 of the Senate Document (p. 14).

	Percentage of Total National Income "Paid Out" 1929		1932	
Labor (Wages and Salaries)....	......	65.1	......	64.5
Property Income:				
Dividends	7.4	......	5.3	......
Interest	7.0	......	11.2	......
Balance on foreign account*	.6	......	.8	......
Net rents and royalties........	5.1	20.1	3.8	21.1
Entrepreneurial withdrawals..	......	14.8	......	14.4
		100.0		100.0

*Net balance on flow of property income; cannot be divided into dividends and interest.

After wages and salaries the largest share going to any of the groups specified consists of "entrepreneurial withdrawals" which means the withdrawals of individual proprietors, including farmers and small business men, whose earnings must be considered partly as compensation for their own labor and that of their families and partly as compensation for their capital investments. Such withdrawals cannot be divided between labor and capital. These incomes added to wages and salaries together account for 79.9% of the total national income in 1929 and 78.9% in 1932. This should end the absurd report that 3 or 4 per cent of the population obtains 80 or 90% of the national income, if the official report ever can catch up with the report in circulation.

However, the above table and comment do not tell all that should be told of income distribution in the two years, for it relates wholly to "income paid out." In 1929 the proprietors of business had of "income produced" in that year an aggregate net excess over distribution through the channels named, of $1,896,000,000, which was a capital gain, while in 1932 they paid out as income to the several groups of recipients the total sum of $9,529,000,000 in excess of "income produced." This was a net deficit to proprietors, an encroachment upon working capital, which went to maintain the individual incomes of recipients above what they could have been if restricted to the income of business in that year. Thus a consolidated income account of all corporations for both 1932 and 1931 would show that all of the dividend payments were made out of capital and that a substantial part of the payments for wages, salaries and interest were also made out of capital, to enable business to "carry on." The total of dividend payments in the three years 1930-33 was $12,696,000,000, while business suffered a net deficit, including these payments, of $23,198,000,000. Hence the loss of capital to maintain wage, salary and interest payments was $10,502,000,000.

It is pertinent to say that although dividend disbursements constituted a distribution of assets among shareholders, they none the less meant a loss of working capital to the industries which lessened their ability to withstand a continuing depression. Some of these dividends were earned during the year, but many of them were not, the latter being maintained in consideration for the needs of shareholders and in hopes that the depression would soon pass away. It is obvious, however, that the conditions were abnormal and that the industries could not continue to distribute either dividends or wages as usual. The losses to working capital in 1932 nearly equalled one-eighth of the total national income in 1929.

The total national "income produced" fell from $83,052,000,000 in 1929 to $39,365,000,000 in 1932, while the total national "income paid out" fell only from $81,736,000,000 to $48,864,000,000. All classes of income declined, but with the exception of "interest" all other classes fell off by a higher percentage than did the aggregate of wages and salaries. Interest payments did not rise in the aggregate, but became a higher percentage of the national income, because they did not fall off as much as the other classes of income. This greater stability was because interest payments usually are fixed by time contracts and are not readily readjusted. A great decline of interest rates has occurred since on new contracts and by readjustments. Notwithstanding the great decline in the aggregate of national "income produced" the several income groups received approximately the same shares of the total "income paid out," but this was largely because of the drafts upon capital.

The share of entrepreneurial income (which includes practically all unincorporated business) although showing relatively but little change in the four years, undoubtedly has been falling in recent years, because of the extension of the corporate form of business organization, but has been also affected since 1921 by the relatively low prices of farm products.

In Conclusion

It cannot be reasonably claimed that the foregoing figures show any such "concentration" of income in a few hands as is commonly represented. A substantial part of the property income classified as from interest, dividends and rents, and particularly that from interest, does not go to the active business class, (which is a payer rather than receiver of interest) or to persons of large incomes. Retired farmers and small tradesmen who have sold the farms or businesses by which they have made their livelihood and possibly acquired other savings against old age, are living on the incomes from those possessions, and many wage-workers have prudently and patiently acquired property incomes in like manner. Many persons are living on inheritances or the proceeds of life insurance paid for in installments and invested to yield income of these "property" classes. Furthermore, the distribution of "property" income, as in the case of wages and salaries, takes place broadly over the country, and this income is mainly of local origin, arising from the earnings, savings, business relations and family relations within the communities where distributed.

After the foregoing explanation we now show below, first the percentage shares of the "national income paid out" actually received by labor in the form of wages and salaries, and the combined shares of all other income recipients, in each of the four years 1929-1932, and then a statement of what these shares would have been if total income distribution had been confined to the income produced in those years with wages and salaries the same as were received and with all other income restricted to what was left:

Distribution of Total "National Income Paid Out"

	1929	1930	1931	1932
	(Per Cent)			
Total Labor Income— (Wages and Salaries)..	65.1	64.4	64.7	64.5
All other Income...............	34.9	35.6	35.3	35.5
	100.0	100.0	100.0	100.0

Distribution of Total "National Income Produced"

(Per Cent)

	1929	1930	1931	1932
Total Labor Income— (Wages and Salaries)..	63.6	69.1	74.8	80.1
All other Income...............	36.4	30.9	25.2	19.9
Total	100.0	100.0	100.0	100.0

Thus in 1932 payments for wages and salaries amounted to 80.1% of the total national "income produced" and all other incomes to only 19.9%.

Profits of the Manufacturing Industries, 1919-1932

We gave two months ago a table showing the consolidated gross and net income, before and after Federal taxes, of all corporations in the United States, in each year from 1919 to 1932, covering the post-war period, excepting 1933, for which official figures have not been made public. This was done to let the light of truth fall on one of the most common illusions of the day, to-wit, that the excessive corporate profits of this period, and their investment for the expansion of industry, was the principal cause of the industrial crisis and depression. The table showed that for the fourteen years the aggregate profits averaged only 2.42% of the aggregate gross income, and that even eliminating the three disastrous years, 1921, 1931 and 1932, the profits averaged only 4.08% of gross income. These figures are unimpeachable, for they are from the reports of the United States Bureau of Internal Revenue.

Moreover, we quoted from a high statistical authority a statement that in the eight years 1922-1929 the manufacturing industries, (to which his calculation was confined) by increasing efficiency and increasing investments of capital, accomplished an average increase in the rate of physical production of 3.8% per wage-worker per year, the benefit going to the public, excepting the percentage of profit shown by the table. In other words, the new gains annually accruing to the consuming public from the increasing efficiency of these industries fell but little short of the average annual profit of the same corporations during those years, and the gains were cumulative and permanent, serving as the basis of further gains to consumers in the future.

These figures are so destructive of the entire case against the economic system that of course they will not be readily accepted. They are destructive not merely because they disprove the misrepresentations of the assailants, but because they practically prove that instead of being controlled in the interest of capital, the system is automatically regulated by economic law, and serves the general welfare, despite all efforts from within or without to control it. The critics of the system would be the last to believe that the proprietors of business had deliberately and by agreement restricted their profits to the figures revealed; hence the reasonable explanation for the low average rate of profit is that competition prevented it from being higher.

It probably will be said that averages are deceptive and that they cover up great profits by comparatively few corporations, also that the figures given have not shown profits upon invested capital. We now offer the following tables covering all manufacturing corporations for the same period, and giving greater details. The upper table divides the corporations into a group reporting net incomes and those reporting no net income, but gives also the consolidated figures, with the percentage of net earnings to gross income. The lower table

gives a consolidated statement of gross and net income, and also of the capital structure of the same corporations as shown by their balance sheets at the end of each year from 1924 to 1929, with a calculation of net earnings to net worth.

It is true that figures for capitalization must be taken with reserve, for not only may stock issues be increased without a corresponding increase of values behind them, but investments which originally represented dollar for dollar of capitalization may deteriorate by obsolescence, mismanagement or otherwise, until they become worth much less than cost. However, the capital figures have little significance unless they represent properties capable of producing net earnings. Real capital consists only of such assets, for nothing else counts in a competitive situation. Obviously a producer cannot increase the selling value of his goods by merely writing up the book value of his assets. A vast amount of uninformed writing and talking is done about the effects of capitalization and price agreements upon prices. Capitalization ought to represent honest values, but falsification in it is more important to investors in the stock than to buyers of the products. This assertion may be disputed, but it is verified by the figures for average profits.

The figures for average profits upon gross business handled show the share of values sold to the public which the industries have been able to retain as compensation for their organized services, over and above the wages and salaries of the working staffs and payments for materials and services supplied outside of these industries.

Comments Upon the Tables

The average profit, calculated on gross business, over the fourteen years was 3.62%; the average on net worth in the nine years was 3.95. If all of the deficit years were omitted, the average profit of the first table would be 4.67% and of the second table 5.88, but this suggestion is made only to show the good years by themselves and not to suggest that the business man should operate only in the good years!

The effect upon profits of fluctuations in the volume of business is readily seen, and it is noteworthy that the average profit is not more than is expected in merchandising, which does not require a hazardous investment in techni-

Gross and Net Income of All Manufacturing Corporations
Compiled from Statistics of Income, U. S. Treasury Department
(In Millions of Dollars)

Calendar or Fiscal Year	Corporations Reporting Net Income			Reporting No Net Income		Consolidated		
	Gross Income	Net Income	Income Tax	Gross Income	Deficit	Gross Income	Net Inc. after Tax	% Net on Sales
1919	$45,705	$5,219	$1,359	$ 6,585	$ 367	$52,290	$3,493	6.68
1920	45,217	4,116	945	11,432	834	56,649	2,337	4.13
1921	24,422	1,778	352	14,020	1,899	38,442	D-473	D-1.23
1922	36,006	3,454	390	8,677	813	44,683	2,251	5.04
1923	48,687	4,272	485	7,534	701	56,221	3,086	5.49
1924	45,320	3,596	430	8,591	832	53,911	2,334	4.33
1925	52,925	4,383	547	7,905	682	60,830	3,154	5.18
1926	52,922	4,495	585	9,573	787	62,495	3,124	5.00
1927	50,134	3,939	508	13,589	851	63,723	2,580	4.05
1928	57,459	4,744	545	9,814	834	67,273	3,366	5.00
1929	59,880	5,216	544	12,252	810	72,132	3,862	5.35
1930	41,054	2,758	317	19,846	1,640	60,900	801	1.31
1931	20,974	1,465	165	23,059	2,288	44,033	D-988	D-2.24
1932-P	10,514	657	86	13,332	2,103	23,846	D-1,533	D-6.48
14 Year Average	$42,230	$3,578	$ 518	$11,872	$1,103	$54,102	$1,957	3.62

Income and Capitalization of All Manufacturing Corporations
Compiled from Statistics of Income, U. S. Treasury Department
(In Millions of Dollars)

Calendar or Fiscal Year	Consolidated		End of Year				% Net Income on Net Worth
	Gross Income	Net Inc. after Tax	Preferred Stock	Common Stock	Surplus Account	Net Worth	
1924	$53,911	$2,334	$ 6,766	$16,665	$12,636	$36,067	6.37
1925	60,830	3,154	7,048	19,861	15,457	42,366	7.44
1926	62,495	3,124	7,431	23,980	14,862	46,273	6.75
1927	63,723	2,580	7,359	24,195	16,496	48,050	5.37
1928	67,273	3,366	7,562	24,929	17,526	50,017	6.72
1929	72,132	3,862	7,009	26,220	19,466	52,695	7.34
1930	60,900	801	6,837	27,018	18,267	52,122	1.54
1931	44,033	D-988	6,884	25,446	15,310	47,640	D-2.07
1932-P	23,846	D-1,533	6,884	25,446	15,310	47,640	D-3.22
9 Year Average	$56,571	$1,856	$ 7,087	$23,751	$16,148	$46,986	3.95

Note—Capitalization figures not available prior to 1924.
D—Deficit. P—Preliminary Report. Capitalization figures as of beginning of year.

cal equipment. It is little more than the common return upon money at interest in the past, and that the difference is so small is accounted for by the losses in active business. Apparently the average business man is over-optimistic in his calculations, and would realize better results by placing his capital at interest instead of in competitive undertakings. But no more discriminating method of screening out the incapable is conceivable.

Gross income is practically the same as net volume of sales, except as the producer may derive income from investments outside of the business, but in such cases a portion of the capital is thus employed, and usually the amount is not large enough to materially affect the income percentage.

Fictitious capitalization can be no factor in the profit percentage based on gross income. It will be seen that this tended to fluctuate rather closely around 5 per cent in average years, and this is the matter of chief importance to this discussion, because the entire controversy relates to the share of the product going to capital. It can hardly be denied that something must be paid to the owners of private capital if private capital is to be used in production for the public market; therefore, the discussion narrows down to the question: How much less than the above average rate of compensation would suffice to maintain the present productive capacity and finance future development? Incidently another question may be asked, viz: What is the annual cost to the American people of the antagonism and strife in the industrial system resulting from current misrepresentations about the division of the industrial product?

The most important thing to be noted is that over the fourteen years, out of an aggregate production averaging $54,102,000,000 in value per year, $11,872,000,000 per year, or about 22 per cent of the total, was produced by companies operating at a loss. We may add a fact not shown in the table, to-wit, that the average number of active companies reporting was 85,651, of which 39,184, or 46 per cent, were operating at a loss. The percentage of companies operating at a loss ranged from 23 per cent in 1919 to 83 per cent in 1932. Calculated by themselves, the companies composing the profit-making group averaged 54 per cent of the average number of active companies over the fourteen years.

The Industries Always Undergoing Change

This showing, of course, does not mean that the same companies were having losses year after year. Continuing losses mean ultimate bankruptcy and elimination from the field. The lists of profit-making and no-profit companies are always changing, because industrial conditions are always changing and affecting different industries differently. The no-profit companies are not always new companies, but in many instances have had long and successful careers. On the other hand, new companies are continually rising into the profit-making list, and old companies which have fallen out of it are often regaining their former position. Always, however, there is a group of no-profit companies, and above this group there is another, perhaps larger in numbers, which while not showing deficits is not in secure position, in the sense of making fairly remunerative profits after proper provisions for depreciation, obsolescence and all the risks of the business. The remainder would show rising percentages up to the comparatively few which for various reasons are operating under exceptionally favorable conditions. The latter may have products that are new or protected from competition in some way, perhaps by patents, or for good reasons they hold leading positions in their lines of trade. There is sharp competition not only within the numerous industrial groups but between these groups for the favor of the buying public—a rivalry through appeals to every varying want and taste—and the large profits are not made by charging higher prices but by ability to produce at lower costs or to make a more popular product. This is the law of profit-making and what fault can be reasonably found with it? The concerns that are leading in profits have no franchise assuring their position. The economic system continually purges itself of members who for any reason are failing to maintain their usefulness.

All Changes Serve the Consuming Public

There is seldom more than a small margin of profit to any competitor who has nothing but routine service to offer. The leaders, who have something exceptional to offer, make the pace. Every innovation of value brings a reward, and naturally the first use of increasing profits is to enlarge production. This policy is continued as long as the demand increases, and if the innovation lowers the cost a part of the gain will be given to the public to stimulate the demand. Gradually competitors will provide the same or some counter-attraction, until all the gain from the first innovation has been transferred to the body of consumers, the final beneficiary of all economic progress.

A writer in the Iron Age a year or two ago gave a flashlight picture of conditions in the manufacturing industries in the following paragraph:

> The "new economic era" boys laughed at saturation points. Where are they now? There's a saturation point for every material object. Only ideas, wants, desires are unlimited. And because these human wants are ever fresh and new, they obsolete material objects every time they find something that serves better. New machines, new tools, new materials, new processes, new forms, are constantly replacing old.

Your product may go out overnight. Sometimes the process is slower. Sometimes the rate of increase in consumption steadily declines even though the whole market is expanding. That's happened in scores of industries. How about yours?

Does this picture support the theory that capital has a strangle control over industry, or does it support the view that all of the industries are eagerly competing for the favor of the consuming public? The fact is that there is no competition so irrepressible as that of new capital with old investments. The stream of new capital which is always coming upon the market is bound to force itself into employment somewhere, for it has an advantage over the old investments in being able to utilize the very latest offerings of science and invention. To the extent that new capital forces itself into employment by destroying old investments, the public does not have both the old and new to support, but gains by the superior service of the new.

The foregoing is not in disregard of the fact that efforts are always being made to mitigate competition, or that benefits may result from intelligent efforts to suppress its abuses and give some degree of stability to business conditions. Such efforts, however, cannot suppress the fundamental forces making for competition. The relative positions of all the factors in industry cannot be fixed. New factors are entering the situation constantly—new men, new ideas, new equipment. No lasting system of quotas can be established; the companies and personalities that are new and of small importance today cannot be persuaded to accept that status permanently, for the sake of peace with long established concerns whom they do not fear. You cannot suppress the natural ambition of men for a place in the sun. The owners of the new capital always becoming available will not consent that it shall lie idle in order that old investments may be undisturbed. The existing order faces a continual challenge by the new.

In normal times when the pace of progress has a degree of regularity, when confidence pervades the business community, the economic system is not disturbed by the changes which are incidental to progress, for every innovation which reduces costs and prices increases the purchasing power of the population, thus creating new demands for products and easing the necessary readjustments. But an abnormal pace of change which throws the system off its normal balance—as the changes forced by War—have the effect of creating disorder, which abnormally stimulates competition. The abnormal rise of wages caused by the War suddenly opened a vast new field for labor-saving machinery, and intensified competition by so doing. The unbalanced state of the industries in production and prices, likewise resulting from the war, has checked the flow of products into consumption and intensified competition for the lessening volume of business. No business man wants to sell goods at less than cost, but if he must do so to meet his obligations and save himself from bankruptcy, he will do it, and efforts to prevent his doing it will not correct the difficulties in the situation. They have their source in the unbalanced condition and there is no remedy but by restoration of the normal equilibrium.

Unemployment Insurance

The above figures showing that always an important body of the manufacturing companies is producing at a loss has an important bearing upon the proposal to establish a system of unemployment insurance at the expense of the industries at this time. It means an increased cost which must either be added to the cost of living, or if accepted by the industries which can endure it would hasten the elimination of the weaker competitors and consolidate business more and more in the hands of the stronger. This would be an abnormal pace of centralization. Granted that such changes may be in the interest of the public where the factors eliminated are hopelessly inefficient and incapable, there remains a question whether a time of distress like the present is opportune for a ruthless application of the doctrine of the survival of the fittest? In 1930, 1931 and 1932 less than one-half of these companies were operating at a profit, and we have no official information since. Thus the majority have been and doubtless still are under pressure, struggling to survive. Is this an opportune time to begin the accumulation of a fund for the relief of unemployment some time in the future, or may that well be postponed until the industries have surmounted their present difficulties? It cannot be helpful to the employment situation to have more burdens placed on employers at this time.

The low average profit of the industries demonstrates the impracticability of all theories which contemplate that employers shall continue to pay wages when the products cannot be sold. Obliged as they are to pay out approximately 95% or more of the selling value of the products in operating expenses, working capital would be rapidly exhausted if there was no income from sales, and enforced sales would carry prices lower and lower with ruinous effects upon employers and employes alike. Taking industry as a whole, every increase of costs will require an increase of prices and result in an increase of living costs to consumers which will compel reduced consumption.

The National City Bank of New York

Head Office:
Fifty-five Wall Street
New York

Capital, Surplus
and Undivided Profits
$166,541,315.86

Condensed Statement of Condition as of October 17, 1934

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers		$365,189,348.01
United States Government Obligations (Direct and Fully Guaranteed)		375,221,377.73
State and Municipal Bonds		73,162,122.48
Other Bonds and Securities		61,751,096.49
Loans, Discounts and Bankers' Acceptances		470,737,415.38
Customers' Liability Account of Acceptances		57,388,736.00
Stock in Federal Reserve Bank		6,600,000.00
Ownership of International Banking Corporation		8,000,000.00
Bank Premises		54,402,409.36
Items in Transit with Branches		16,230,720.26
Other Assets		5,464,238.38
Total		$1,494,147,464.09

LIABILITIES

Capital		
Preferred	$50,000,000.00	
Common	77,500,000.00	
Surplus	30,000,000.00	
Undivided Profits	9,041,315.86	$166,541,315.86
Reserves for:		
Unearned Discount and Other Unearned Income		2,512,658.51
Interest, Taxes and Other Accrued Expenses		3,828,239.54
Dividends		
Preferred		502,267.50
Common		1,550,000.00
Liability as Acceptor, Endorser or Maker on Acceptances and Bills		66,505,299.26
Deposits		1,252,707,683.42
Total		$1,494,147,464.09

Figures of Foreign Branches are as of September 25, 1934

United States Government Obligations and other securities carried at $132,298,331.00 in the foregoing statement are deposited to secure public and trust deposits and for other purposes required by law.

City Bank Farmers Trust Company

Head Office: 22 WILLIAM STREET, *New York*

Condensed Statement of Condition as of October 17, 1934

ASSETS

Cash and Due from Banks and Bankers	$13,180,477.08
Loans and Other Secured Advances	12,388,479.13
United States Government Obligations (Direct and Fully Guaranteed)	16,389,214.26
Other Bonds, Mortgages and Securities	14,700,746.04
Stock in Federal Reserve Bank	600,000.00
Bank Premises	4,925,365.70
Other Assets	2,006,089.44
Total	$64,190,371.65

LIABILITIES

Capital	$10,000,000.00
Surplus	10,000,000.00
Undivided Profits	2,472,421.16
Reserves	260,886.33
Deposits	41,457,064.16
Total	$64,190,371.65

United States Government Obligations and other securities carried at $27,566,538.30 in the foregoing statement are deposited to secure trust deposits and for other purposes required by law.

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